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SUBJECT: URANIUM: THE REVIVAL OF ENERGY'S "OTHER WHITE MEAT"

SUMMARY

1. The international media buzz generated by Alberta's booming oil and gas industries has overshadowed a revival of interest in western Canada's uranium resources. Seemingly destined to be the "other white meat" of Canada's energy industry, uranium's fortunes had been in decline for a quarter-century before spot prices surged earlier this decade. From an all-time low of US\$7 per pound in 2001, uranium nearly quadrupled in value over the next two years, before reaching its current 15-year high of US\$33. Canada, with the second largest uranium reserves on the planet, is responsible for nearly a third of world output; this proportion is expected to climb to half by 2015. The province of Saskatchewan is home to all of Canada's mines, as well as the world's largest uranium producer, Saskatoon-based Cameco Corporation (uranium produced in Saskatchewan generates electricity for 1 in 9 American households). With reserves of almost 450 million pounds, McArthur River is the world's largest mine producing nearly 18 million pounds of uranium yearly. The future looks bright for the western province governed by a socialist New Democratic Party that has struggled over the years with the social implications associated with developing a sector that continues to garner a strong "not in my backyard" response. With uranium revenues (C\$40-50 million is earned by the Government of Saskatchewan yearly from uranium royalties and industry taxes), and therefore royalties, the provincial coffer is almost guaranteed to climb as emerging nations develop peaceful nuclear power capabilities. Cameco has also been dismantling nuclear warheads in the former Soviet Union since 1999. End summary.

RADIOACTIVE, AND PROUD OF IT

2. Saskatchewan has long been a world leader in uranium production. Mining in the Athabasca region of northern Saskatchewan has been around almost as long as the uranium industry itself, and has been an important component of the West's nuclear power program from the Manhattan Project on. The province currently produces about 32% of the world's total, and numerous development projects are underway to increase this proportion to over half by 2015. At current rates of consumption, Saskatchewan has enough economically viable reserves to last 25 years, and with US\$30 million in ongoing exploration projects, the province has the potential to continue as the uranium capital of the world for much of the century. Saskatchewan has derived many benefits from hosting the uranium industry, not the least of which is the C\$256 million in goods and services those companies purchase every year. Uranium mining has been a godsend to northern Saskatchewan, where it is the largest private sector employer.

THE RISE OF THE YELLOW BLACK GOLD

3. While the rationality of market swings in volatile commodities is difficult to determine, several factors seem to have contributed to the rapid rise in the price of uranium after 2001. Perhaps most prominent was the Russian warning early that year that they might discontinue exports of the highly enriched uranium (HEU) they acquired after the dismantling of their nuclear warheads. Nuclear power facilities, accustomed to relying on such secondary production sources for their fuel needs, were forced to take a hard look at the lack of primary production around the world. The program continued, but damage had already been done.

4. Further aggravating the production deficit, Saskatchewan's McArthur River mine, responsible for one-fifth of the world's production, was faced with a water inflow problem that effectively shut it down for several months. With prices falling and several mines worldwide announcing plans to decrease production, former Cameco CEO Bernard Michel predicted that world production of uranium would meet only 40% of world demand by 2010, down from 60% in 2001. A smaller factor, but emblematic of the downward trend of the uranium industry, was the news that British Nuclear Fuels, an important player in the uranium hexafluoride (UF6) manufacturing and shipping industry, was

phasing out its Springfield, England plant.

15. While these factors had a negligible impact on production for an industry that defines "short-term projects" as lasting more than ten years, they inserted a new logic into the uranium market. Previously, uranium consumers knew they could rely on commercial stockpiles to make up the difference between consumption and production. However, with the continued decline in primary production and a 19-year drain in stockpiles, nuclear power facilities worldwide clamored to buy up available supplies. The resulting price increase has fueled a 21st century uranium rush in Saskatchewan, the western province traditionally known for its wheat, open prairies, and unspellable name.

HOMEGROWN COMPANY MAKES IT BIG

16. If Saskatchewan is the uranium capital of the world, then Cameco Corporation is its king. The company is the largest uranium producer in the world, accounting for one-fifth of existing production, and more than two-thirds of identified future capacity. Cameco has a controlling interest in two of Saskatchewan's five mines, plus a 50% stake in the lucrative Cigar Lake development, which is expected to be operational by 2007. Cameco and AREVA (a subsidiary of Government of France-owned COGEMA), together produce over 90% of Saskatchewan's uranium. The world's most productive mine, McArthur Lake, is 69% Cameco-owned. With an ore grade 100 times that of the world average for uranium mines, McArthur has been the company's cash cow since it opened in 1999. It is the world's largest high-grade uranium mine with reserves of almost 450 million pounds. It allows Cameco to produce almost 18 million pounds of uranium yearly. Uranium is considered economical to mine if the concentration is in excess of 0.1%; McArthur Lake has an average concentration of 24.7% U3O8 (uranium oxide, commonly known as yellowcake). Cameco is also the world's sole commercial supplier of UO2, the fuel used in Canadian-designed CANDU reactors. Uranium produced by Cameco generates electricity for 1 in 9 American households. Altogether, Canada exports 5 million kilograms of uranium to the United States every year, supplying 6.5% of American electricity consumption.

17. Cameco has weathered a succession of threats to its viability in recent years, starting with the catastrophic drop in uranium's spot price during the late 1990s. At the time, Cameco was also faced with a PR nightmare, after a chemical spill at its facilities in Kyrgyzstan prompted a public outcry and government inquiry. More recently, the company's failure to acquire a stake in an enrichment facility in southern Texas disappointed investors. Cameco has made several attempts to provide enrichment services; the Bruce Power reactors in Port Hope, Ontario are scheduled to soon begin using slightly enriched uranium (SEU), which Cameco hopes to supply. Cameco had planned to develop enrichment facilities in Port Hope itself as recently as September, until public concerns and technical issues put the project on hold indefinitely. Cameco has since made public its bid to acquire Zircatec Precision Industries (also located in Port Hope), a reactor fuel fabrication company. If the proposal comes to fruition, Cameco will buy SEU from one of three undisclosed US sources, which Zircatec can convert into a useable form for the Bruce reactors.

HUNGRY DRAGON DISCOVERS "THE WHEAT PROVINCE"

18. Uranium is increasingly an important revenue source for Saskatchewan. The C\$40-C\$50 million sent to Regina every year from uranium royalties and industry taxes may comprise less than one percent of total government revenues, but it has enabled significant debt reduction in a province that was on the verge of bankruptcy just 12 years ago. Royalties are expected to increase substantially over the next five years, as industry leaders such as Cameco develop new long-term contracts based on higher spot prices. In the meantime, the provincial government is aggressively courting uranium mining interests. Chinese nuclear power facilities in particular have expressed interest in acquiring a stake in Saskatchewan uranium. Premier Calvert recently returned from high-level talks with China National Petroleum Corporation, attracting attention to the increasingly close relationship between Chinese business and the provincial government. Business-to-business ties have also increased; several Chinese investors have visited Cameco's headquarters in Saskatoon, where they indicated a preference for Saskatchewan's high-yield mines over less rich facilities in Australia.

THE AGE OF THE ATOM, AGAIN?

19. After a 30 year hiatus, nuclear power appears to be making a comeback, as evidenced by new reactors planned in Asia and even

polls in the U.S. showing 60% of Americans support an increase in the use of nuclear power. While the NIMBY (not in my backyard) effect is as strong as ever, Saskatchewan provincial officials, along with Cameco, have set their sights on accommodating President Bush's support in his 2005 New Energy Policy Act to build new nuclear power plants by the end of the decade. However, Saskatchewan and Cameco have had their efforts to receive similar recognition from Ottawa fail, partly because of a strong anti-nuclear lobby. Former Saskatchewan NDP deputy premier Dwain Lingens, now an executive of Calgary-based Nexen Inc., has spearheaded support for new nuclear power facilities, campaigning to convince Saskatchewanians that a plant in the northwestern part of the province would be a huge economic opportunity. The construction rush on the Alberta oilsands has raised speculation that nuclear power could fuel new bitumen processing; nearly one third of the energy reaped from mining the oilsands must be used merely to pump it out of the ground. Initially, nuclear's proponents believed the Kyoto Protocol, which commits Canada to reducing its greenhouse emissions by 6%, would help their cause; however, Ottawa's plan for fulfilling the agreement has no mention of nuclear power, instead focusing on "clean fuels" such as natural gas, solar, and wind power. The uranium industry would like to see the reduction in greenhouse emissions resulting from use of Saskatchewan's U308 counted into Canada's total. Use of Canadian uranium in the United States alone avoids an estimated 230 million tons of greenhouse gas emissions, over a third of Canada's total.

COMMENTS

10. While uranium mining will never be the boon for Saskatchewan that oil and gas have been for Alberta, the province is likely to be increasingly identified with the industry. With companies like Cameco and COGEMA expanding in Athabasca, Saskatchewan has the opportunity to shed its anti-business reputation, stemming the tide of money and skilled workers to neighboring provinces. Numerous challenges face Saskatchewan's uranium mines, such as competition with the booming diamond industry for experienced drillers and geophysicists, and the prospect of a downturn in new nuclear power construction worldwide. However, with spot prices high, and headed higher, Saskatchewan companies like Cameco have a rare opportunity to promote their product in a way once impossible for the cash-strapped industry. Saskatchewan's uranium fields continue to benefit the United States by providing a stable supply of an unstable resource.

11. During a July visit to Calgary, Treasury Secretary Snow was briefed on Saskatchewan's uranium by Cameco President Jerry Grandey. Grandey also hosted former Ambassador Cellucci and the CG for a tour of the McArthur River mine in September 2004 (see 2004 Calgary 536). In partnership with Russia and the USG, Cameco has been dismantling nuclear warheads in the former Soviet Union since 1999. The target is to dismantle 22,000 weapons. By October 2004 when we visited the mine, almost 8,500 had actually been dismantled.

12. This cable was drafted by our fall intern, David Dill.

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